



United States Agency for International Development

Banking Supervision Project



FINAL REPORT

Contract No. NIS-I-00-98-00035-00 - Task Order No. 2
Period of Performance: October 1999 - July 2002

Cognizant Technical Officer: Steve Gonyea

Prepared by
H. Peers Brewer – Chief of Party

Submitted by
Booz | Allen | Hamilton

TABLE OF CONTENTS

Section	Page
I. Final Report	
1. Introduction	I-1
2. Executive Summary.....	I-1
3. Operating Environment	I-1
4. Macedonian Financial Structure	I-2
5. The Institutional Framework	I-3
6. The Project's Mission and Strategy	I-4
7. Task One: IT/MIS	I-5
8. Task Two: Bank Rehabilitation Agency and Deposit Insurance Fund	I-7
9. Task Three: The National Payments System	I-8
10. Task Four: Supervisory Department/NBRM	I-9
11. Task Five: Training of Macedonians	I-11
12. Task Six: Expansion of Supervisory Program	I-11
13. Task Seven: Regional Linkages of NBRM	I-11
14. Task Eight: Fair Access to Credit and Barriers to Corruption.....	I-12
15. Unwritten Obligations and Opportunities.....	I-12
16. Where Does USAID Go from Here?	I-13

II. Attachments

- 1. An English Translation of the Macedonian Chart of Accounts**
- 2. Management Information System and Credit Risk Management**
- 3. Treasury Department Risk Management and Solutions in Macedonia**
- 4. National Payment Card Presentation in Macedonian**
- 5. E-Banking in Macedonia**

MACEDONIAN BANKING PROJECT

INTRODUCTION

Under the provisions of the Task Order, Booz Allen Hamilton was engaged by the United States Agency for International Development to render technical assistance to the National Bank of the Republic of Macedonia and other Macedonian institutions in the financial sector. This assistance included mainly working with the Supervisory Department of the NBRM, commercial banks, the Deposit Insurance Fund and the professional training of people in those institutions.

The Chief of Party (CoP), H. Peers Brewer, arrived in Skopje in January 2000. The project was scheduled to last through the end of October 2001. Carolyn Brearley of USAID/Skopje, the Project's Technical Officer, however, arranged for the Project to receive additional funding and to extend the tenure through the end of April, 2002. The Task Orders (TOs) remained essentially the same as in the original Orders, with some refinements to assist with the changing needs of the local Macedonian situation. In June 2001, the US Ambassador in Skopje ordered the mandatory evacuation of USAID and USAID project personnel out of Macedonia for security reasons. The CoP of the Macedonia Banking Project (MBP) relocated to a Booz Allen Hamilton office in Zagreb, managing the Project's affairs from that location. The Project Deputy, Mr. Kiril Minoski, continued to maintain contacts with the Project's customer base in Skopje and to advance the tasks they were working on. In this regard, Mr. Minoski did an excellent job as a representative of Booz Allen Hamilton and the Project. The mandatory exile lasted until the end of October 2001. At the end of April 2002, the life of the MBP was extended through July 15, 2002 on an unfunded basis.

EXECUTIVE SUMMARY

The CoP of the Macedonian Banking Project had the personal goal of achieving significant and lasting success in the major TOs governing the project. This was done with respect to: (a) the strengthening and training of bank examiners; (b) strengthening the legislative foundation and the capacities of the Deposit Insurance Fund; (c) converting banks to the use of IAS; and, (d) strengthening the credit risk management and MIS framework of the commercial banks. This success was largely the direct result of the close cooperation between the Project and the staff at the USAID Mission in Skopje.

OPERATING ENVIRONMENT

The Macedonian Economy

The general weaknesses of the Macedonian economy have been frequently recorded. These include: high unemployment, widening income inequality, weak social safety nets, uncompetitive export products and a persistent corruption problem. On the more positive side, there is an active underground economy, inflation remains modest, the educational level (at least

in urban areas) is reasonably high and private sector debt is modest compared with many developing countries.

From the perspective of the MBP, the war in Kosovo in 1999 and the ensuing war with the Albanian militants in 2001, compounded economic problems and further retarded economic growth by placing undue pressure on the credit quality of existing loans, which aggravated the already severe problem of non-performing loans in the system's total portfolio.

The Macedonian Financial Structure

The nation's financial structure is divided into three parts: the National Bank (NBRM), the commercial banks (numbering 22, with 95% of the financial sector assets), and "other" which includes a small and weak insurance industry, pension funds and savings banks. The "savings banks," in Macedonia often are more closely in line with American commercial finance companies than retail savings & mortgage operations. Most customers were in the first two categories.

The Supervisory Department of the NBRM (SD/NBRM) proved to be staffed with exceptionally talented and well-trained people. It is worth noting in this regard that the SD/NBRM benefited from the help of a prior USAID project. It was definitely constructive that the MBP could build on the foundation laid by that project. The "foundation" was not just the technical advice, but also the SD's perception of the quality of the consultants that USAID/Skopje put into the field. The weakness of the SD/NBRM was that the department was young and therefore, consequently short on field experience. This was complicated by the fact that the IMF continually (and often without much thought) pushed the SD to expand their capabilities as a condition for additional funding to Macedonia. Be that as it may, these conditions provided a receptive and capable field for the services of the MBP.

The situation with the commercial banks was less satisfactory. These banks also had the benefit of a prior USAID project. While the project had some fine people and a worthwhile program, the project contractor went bankrupt mid stream, leaving the project without the means to continue in business and to make a lasting impact.

Parenthetically, USAID projects, of course, are in direct competition with projects sponsored by the EU, by European central banks and by Non Government Organizations (NGOs). Foreign aid from the West has been available to the Macedonians for about a decade. The Macedonians, consequently, are fully aware of who is a qualified consultant and what types of projects are important to them. Moreover, they quickly develop a sense of which project can deliver and which cannot. Macedonians seem to prefer to work with USAID because: (a) the Americans are more flexible and more willing to customize the aid to the Macedonian need; (b) the American bureaucracy is much less rigid than the European bureaucracy; (c) Americans are much more inclined to get down to the nitty-gritty of "how to" do a task and then stay the course until it is done; and, (d) the Europeans seem to prefer to give technical advice (e.g. what type of computer meets the specifications for a certain operation) and leave it at that. The bottom line and the pragmatic fact is that the American consulting style works best in the emerging countries.

Therefore, USAID must have the patience and persistency to stay the course if it is important to our national interests.

The commercial banking industry in Macedonia, as in many former socialist countries, continued to carry forward operating legacies of that past regime.

These legacies foremost, had: a lack of credit culture, inadequate accounting, no customer orientation and a poverty of managerial talent. Under the old system, the banks were the medium through which the government distributed funds to the state owned companies. It has been a tremendously difficult road for the banks to culturally move to a Western style of banking. As a consequence, there is a curiously inverted situation where the central bankers are more advanced in their development than most commercial bankers.

Some banks do indeed have good quality management, but even in these cases, the talent is limited in number. These banks are the most promising to work with, but they tend to have an organizational structure that resembles an acute isosceles triangle. Thus, the banks' decision makers are far removed from the market place, decision-making is concentrated at the top and (as a complication) the MIS is usually not adequate. This in turn, means that it is difficult for these managements to maintain sustained contact with a problem until it is solved.

The Institutional Framework

While the CoP is unquestionably responsible for the outcome of the project, in truth the project operates within an institutional framework that conditions the probability of that outcome. The MBP was extremely fortunate that it came to Skopje at a time when four of the potentially most important allies were strongly supportive of the project's goals. In particular, the Minister of Finance, Nicola Gruevski, arguably one of the most important cabinet ministers and unarguably the most capable, was strongly oriented toward improving the operating structure and legal foundation of the MBRM and the commercial banking system in Macedonia. In addition, USAID/Skopje had a results oriented view towards getting constructive and sustainable changes made in the financial sector. In particular Steve Gonyea, (Senior Private Sector Officer) Caroline Brearley and Sharon Hester (both Private Sector Officers and Technical Officers) took the time to understand the issues and their complexities in the banking area. They facilitated TO amendments where necessary and were a willing and important part of the calling effort with the customers. In addition, they supported the budget adjustments, which made it possible for the Booz Allen team to address the continually changing needs of the banks, the Supervisory Department and other financial groups. A close working relationship was developed with Mr. Walter Zunic, the World Bank advisor responsible for coverage of the Macedonian SD. Through this relationship Booz Allen Hamilton was able to have a closer understanding of where the SD should be headed and how we could jointly focus our resources to that end. And (d) Booz Allen Hamilton was able to identify and provide three top level STAs (Robert Hefner, Thomas Fitzgerald and Gheorge Campeanu) that were able to make definitive and enduring contributions in their areas in Macedonia.

In conclusion, this institutional support made it inexcusable to fail and improbable to do so.

THE PROJECT'S MISSION AND STRATEGY

The Project Mission

While the Macedonian political, economic and financial situation constantly evolved during the life of the MBP, Booz Allen Hamilton used the black and white of the contract Task Orders (TO) as the primary guide to the Project's activity.

The contract states: "The overriding objective of this task order is to develop a strong supervisory capacity at the National Bank of Macedonia in order to promote a strong, risk-based, market oriented banking system." The TO then enumerated eight tasks. While some of the tasks overlapped and some were outmoded by time and circumstance, Booz Allen Hamilton assessed each task and each opportunity for service, which surfaced during the life of the Project by the "overriding objective[s]" of developing a "strong" SD/NBRM and a "sound, risk based market oriented banking system."

The Project Strategy

When the MBP arrived in Skopje, one of its first undertakings was a survey of the needs and attitudes of the customer base. The CoP interviewed the SD, the Deposit Insurance Fund, eight banks (representing 85% of Macedonian deposits), the IMF/Skopje, the World Bank/Skopje, the Ministry of Finance, other financial sector projects in Skopje and several USAID projects in other Eastern European and FSU jurisdictions.

What Booz Allen Hamilton saw and heard about was a lot of activity but very few sustainable improvements from this activity. This was due to several reasons.

First, the customers were polite but clearly skeptical about the commitment of the consultant. They felt that consultants tended to be driven by their own agenda and not by the needs of the Macedonian agenda. Second, the customers did not like the patronizing approach of the "three day pundits" that came in and out of Petrovic. Skopje is not a grammar school. Third, people who attended the seminars were often too junior in their organization to understand how this information could be effectively used in the corporation. Moreover, these same people lacked the standing or ability to package and present the ideas to those in the organization who could make a difference. Finally, the consultant is by definition an outsider. It is hard for the outsider to know what is going on within the Macedonian institutions because there is very little financial or strategic transparency. The consultant, consequently, is challenged to focus the program in a way that is truly responsive. Yet, many Macedonians evidently do understand what is going on. They understand because they have access to "ozborouvanie," a vast under ground current of chatter that surfaces primarily in close social settings. If the consultant wants to know what is going on, he must drink of the waters "ozborouvanie".

To by-pass these negative factors and create a more participative relationship, the MBP strategy was to: first, initially concentrate on one important customer. That is, the Project would build its credibility with service to that customer. By "ozborouvanie," word would quickly get around. Booz Allen Hamilton selected the SD because of its sophistication and understanding of where it

needed to go. This decision was in part facilitated by: a) the fact that the number one and three banks (representing 445% of assets) were in the process of being taken over by foreign banks; b) the number four bank was in a problem band classification; and, c) the number two bank specifically declined an offer for help. The commercial banks were preoccupied with other problems. Second, use only STAs with years of direct line experience in that business and with very relaxed people skills. No academics need apply. Third, the Project would suggest but not push issues on the Macedonians, since Booz Allen Hamilton was confident that over the life of the Project, these issues would arise among their customers. By letting the customers know early on of Booz Allen Hamilton's willingness to help, when the issues did arise it created a demand-pull for their services, which is a much more favorable condition for the success of a consulting initiative. And fourth, hire a local staff that traveled in the same social circles as the customers Booz Allen Hamilton was trying to serve. Also the CoP would make a direct effort to participate as much as possible in the cultural and social life of the country. By and large, these strategies paid handsome dividends for the MBP.

TASK ONE: IT/MIS

Task One deals with accounting and Information Technology/Management Information Systems (IT/MIS) issues. This was a very complicated TO. The MBP had hoped to have this TO completely resolved by July, 2001, but the mandatory exile postponed the completion date until February, 2002. This TO actually had three component parts: first, streamlining the regulatory reporting process, second, getting banks to use IAS, and third, helping them with IT/MIS issues. Each of these parts involved different analytical and consultative skills.

First, the request of the TO that the Project help streamline the regulatory reporting process actually derived from a mis-assessment of the situation by the people who did the feasibility study for the project. Reportedly, the bankers were upset with the burden of financial reporting which the NB required, thus diverting time from more constructive applications. Two things suggested, however, that this was not a real issue. One, during the CoP's initial surveys of the banks, not one bank raised this as a serious issue unless prompted by the CoP. Two, the CoP got a hold of the list of reports the banks had to supply the NB. Upon reviewing the list, it was evident that all of the reports generated information that the regulators had a right to know – particularly mindful that these reports were used for both supervisory and monetary policy purposes. Ultimately, Booz Allen Hamilton came to the opinion that during the time the people doing the feasibility study for this Project were in the field, the NB had just begun to insist that the banks report balance sheets on an IAS basis in addition to the normal Macedonian accounting basis. This was a cosmetic response of the NB to requests from the WB and the IMF that banks report on an IAS basis. Most banks did not have the remotest idea of what IAS entailed and it is doubtful if at that time the NB itself knew any better. Since the Projects main objective under Task One was getting the banks to use IAS, it was not constructive to ask the NB to drop this reporting requirement. Rather Booz Allen Hamilton asked them to maintain the requirement, while the MBP would then help the banks learn the proper way of setting up, reporting and utilizing IAS accounting.

Second, as mentioned above, this was a perplexing TO in some respects, none more so than in getting the banks to use IAS. During the tenure of the MBP there was also a USAID project, two

actually, devoted to accounting issues and with a primary assignment to advance the use of IAS among all Macedonian corporate entities. The Accounting Project had a very difficult time of it because the topic was highly politicized. The control of accounting in Macedonia, its teaching and enabling legislation was tightly controlled by the university academics. This was a lucrative slice of business that they were not about to relinquish. Booz Allen Hamilton struggled for a way to address this TO. Opportunity, however, did strike. In April 2001 the World Bank mandated the use of IAS accounting for the banks. In March 2001 the NB came to Booz Allen Hamilton, asking to do a study that compared IAS accounting with Macedonian accounting, preparatory to recommending to the Ministry of Finance new legislation regarding the use of IAS. The question was who would do the study, which involved extensive knowledge of IAS and Macedonian accounting and the analytical ability to understand the subtleties of comparing the two systems on theoretical and “applied” levels.

After consulting with the NB and with the Accounting Project, Booz Allen Hamilton identified and hired a local individual who did an outstanding job for Booz Allen Hamilton and the NB. Using this same individual, who had considerable teaching and seminar experience, Booz Allen Hamilton designed an entirely unique course which taught the internal accountants the theory behind IAS, how to set-up the accounts and how to maintain controls through the presentation of the balance sheet, profit and loss statement and cash flow. This course involved about 24 day sessions, some outside of Skopje to spread the travel burden of the bank accountants living outside of Skopje. About 60 different individuals attended, some for special subjects, with about 40 actually receiving graduation certificates.

Also, Robert Reed, CoP of the Accounting Project and Peers Brewer, CoP of the MBP, jointly presented a seminar for bank credit departments showing them what new accounting look they would be getting when their customers shifted to IAS and how this would impact the credit analytical process. About 65 people attended this seminar.

Finally, prior to conversion of the banks to IAS, and while discussions about that were in progress with the WB, IMF, MOF, USAID and NB, the MBP became aware that the Macedonian bank chart of accounts had never been translated into English and none of the Western parties to this discussion knew what the accounts looked like. The MBP, accordingly, with the help of the Accounting Project, hired a translator who specialized in accounting and business issues to do the translation. The translation was made available to all interested parties and Projects. (See Attachment Number 1).

Third, the use of IT/MIS in the banks was also difficult to get going because: (1) the two banks that were bought by foreigners (combined with over 45% of Macedonia’s deposits) were implementing the systems of their new parent bank; (2) several other large banks seemed reluctant, again, to have outsiders get too familiar with the internal conditions of the bank; and, (3) a total change was underway in the payments system, with the banks knowing very little about what stress this change was going to mean to the structure of their own system requirements.

Discussions with banks in another jurisdiction that had IT projects (software), felt that the project did not meet their needs because the banks did not know in the first place what was needed in

terms of MIS to manage their institutions. Normally IT systems are designed based on MIS requirements. Booz Allen Hamilton felt that it was most urgent in the Macedonian bank setting to get versed in MIS. That is, what information did each bank need at each level of seniority to effectively manage the risks inherent in the business? They needed to be shown what happens in the governance process as controls come down by directives from the Board of Directors to senior management to the line officers, and what is the timely return flow of information based on results. In response to this need, the MBP held two major seminars in February and March 2002. One was entitled “Management Information Systems and Credit Risk Management” (see Attachment Number 2) and the other “Treasury Department Risk Management Issues and Solutions in Macedonia” (See Attachment Number 3). The first was given by Peers Brewer and the second, by Gheorghe Campeanu. Both of these seminars were developed specifically with the Macedonian situation in mind. Both dealt with the underlying business practices and included numerous examples of actual MIS reports used in Western banks to show what information was needed in form and substance. Approximately 65 individuals attended each of these seminars. Both seminars led to considerable direct follow-up activity with the banks, including on the Treasury side, a concentrated consulting assignment with the Treasury Department of the Macedonian Development Bank.

TASK TWO: BANK REHABILITATION AGENCY AND DEPOSIT INSURANCE FUND

At the time the MBP arrived in Skopje, the BRA had been legislated to go out of existence. The Bank Rehabilitation Agency (BRA) was founded as a special situation agency. The special situation was that Macedonia’s largest bank, Stopanska Bank was in deep trouble due to poor loan quality. The government owned the bank. This was not an institution that the government wanted to see fail, but no one would buy the bank given its bad credit characteristics. Therefore, a special entity, the BRA, was created to take the bad loans out of the bank to “clean it up” for sale. The BRA, it was hoped, would then sell off the bad loans and recoup part of the funds that the government had to inject into the bank when it withdrew the bad loans.

The CoP visited with Besnik Fetai, the General Manager of the BRA. The portfolio was disappointing. Stopanska Bank had very little credit culture, therefore the loans it generated had little residual values when they went bad, except by chance. The loans that did have a hidden value had been already picked over. The use of a special facility like the BRA has been in use by American banks on a rare basis since the Great Depression. Since the 1990s, this approach has been used in emerging Asian countries with a degree of success. In Macedonia’s case however, the gross amount of these loans was too small to attract the attention of cross border investment bankers (who handled the Asian debts) and Macedonia did not have a country grade and no internal means of buying the bad debts. Therefore, there was little that could be done with the BRA that Mr. Fetai had not done.

In the second area, service to the Deposit Insurance Fund, the timing of Booz Allen Hamilton’s arrival turned out to be particularly favorable. In May 2001, the MOF undertook the task of rewriting the legislation governing the operations of the DIF. The MOF asked the MBP to review the possible modification as contained in Articles 93-107 of the revised Banking Law. In reviewing these sections, Booz Allen Hamilton found several major problems, including a large uncovered FX exposure. The Project made two major and two minor recommendations of which

one of the major and both of the minor recommendations were incorporated into the new legislation.

One of the unique problems of the DIF at this time was that while it was becoming a solid company, few depositors even knew they were covered or to what extent. This was a particularly vexing problem since one of the reasons for having a DIF was to restore confidence of depositors in the banking system. The MBP, consequently funded a web site for the DIF that depositors could access and financed the design and printing of brochures which the banks could place on the counters where the depositors came to transact business.

Lastly, the DIF asked Booz Allen Hamilton in January 2002 to finance a new computer system to replace its antiquated system, which became impossible to do. However, when the MBP came to the end of its contract in July 2002 Booz Allen Hamilton donated to the DIF, with USAID's approval, their office PC and other office equipment. The Macedonian DIF, under the administration of Ms. Lilianja Bozenovska is probably the best such insurance operation in the former socialist countries. The DIF was very receptive to USAID's help. As a consequence, the Fund was significantly strengthened.

TASK THREE: THE NATIONAL PAYMENTS SYSTEM

Task Three involved support for the change of the old payments system (ZPP) to a new, more market oriented system. While the TO envisioned the MBP playing a role in the system design, responsibility for that task was given over by the EU before the MBP was put up for bids. By the time Booz Allen Hamilton arrived in Macedonia, the system design and selection of hardware and software was all completed. The Europeans brought in a payments design expert from the UK, named Robin Reed, who did an excellent job.

At the end of the design phase, however, the European involvement came to an end. The Macedonians put one of their top young men, Dane Krstevski, in charge of the payments conversion. About six months earlier the Booz Allen Hamilton Project tried to hire Krstevski to head their participation in the ZPP conversion. At that point the Governor of the NB matched Booz Allen Hamilton's offer and put Krstevski in charge of the project for the NB. In that regard Booz Allen Hamilton had a decisive influence (although unintended) on the success of the conversion, since Krstevski turned out to be an excellent man for the job.

The conversion saw the old ZPP divided into two parts: the Real Time Gross Settlements (RTGS) part (owned and managed by the NB with Krstevski at the head) and the Clearing House Association (smaller clearings, owned by the commercial banks). Booz Allen Hamilton developed close relationships with both groups. In particular Booz Allen Hamilton counseled Krstevski on the content, pacing and direction of his conversion effort. Kiril Minoski, Deputy Head of the MPB attended all the monthly weekend meetings between the Real Time Gross Settlements and the bankers in the Winter and Spring of 2002. Booz Allen Hamilton's efforts to get more closely involved, however, were not picked up by the RTGS. It should be said, however, that the Macedonians largely did the job by themselves and did it with very few hitches, which is quite remarkable given the size and the timetable of the conversion process. In the Summer and Fall of 2001, however, Mr. Minoski was a member of the Marketing

Subcommittee of the Payments Conversion Task Force. In that position he helped design the conceptual framework for the public educational phase, which the MBP sponsored financially.

With regard to the Clearing House Association, Booz Allen Hamilton met with Goran Anastasovski, the first GM, and Stefece Stefanoski, second GM, on several occasions with proposals to assist their development. In this context Booz Allen Hamilton provided a detailed presentation about the New York Clearing House, how they operated and what services they made available to their member banks.

In April, 2002, Booz Allen Hamilton sponsored and sent two Macedonian Clearing House officers to a regional conference in Minsk of all the clearing houses in Central and Eastern Europe. It was recognized that closer cooperation between these clearing houses is imminent, which Booz Allen Hamilton agreed with.

In a development closely related to the reform of the payments system, in October 2001, Vladimir Milukov, Manager of the newly formed National Payment Card, came to us for consulting help. Through this card (essentially a debit card) the MOF hopes to improve tax collection, reduce corruption and reduce what is a relatively large amount of cash circulating in the system. The MBP rapidly developed a close relationship with the NPC. They were in particular need of advice covering their start-up phase, including: legal relationships with vendors, customer service, software, forms-and-documents, ATM management and similar topics. Since Croatia had itself just gone through such a start-up experience, Booz Allen Hamilton met with the Croatian NPC officials and hired them to come to Skopje to consult directly with the Macedonian NPC. The effort went very well from all perspectives. Subsequently Mr. Minoski helped design the NPC's public relations launch effort, which the Project funded. The NPC is now open and doing business. While one may tend to despair about the rate of change in the Balkans, in point of fact, in Macedonia, a large number of developments have happened in the financial sector, much of it, like the NPC, supported by USAID. Again, this is a good example of the constructive results that can happen when the local USAID unit and the project are alert to emerging trends in the market and join forces to respond.

TASK FOUR: SUPERVISORY DEPARTMENT/NBRM

Task Four deals with assistance to the Supervisory Department of the NBRM. As noted above, the TO said "the overriding objective of this task order is to develop a strong supervisory capacity at the NB..." As with the DIF, the timing of the Project's arrival in Skopje coincided most fortuitously with the consulting needs of the SD.

In October, 1999, the Macedonian government had entered into an Action Plan with the IMF and the WB regarding a list of activities or goals that they wanted the SD to fulfill during 2000 and 2001. In general, these goals concerned the technical supervisory skills of the SD. The fulfillment of these goals was a conditionality to further funding by the IMF/WB. Each of these goals, accordingly, had a specific time frame. In effect, this time frame put the NB under pressure and gave the MBP the leverage to become a significant factor in the SD's plans.

In January, 2000, shortly after the Booz Allen Hamilton team arrived in Skopje, the CoP met with Dr. Gilgor Bishev, the Deputy Governor of the NB with direct responsibility for the SD. By education and temperament, Bishev was an outstanding man for this position. The purpose of this meeting was to explore the ways that Booz Allen Hamilton could be of assistance to the SD. The outcome of the visit was a letter of January 31, 2000 from Bishev to Mr. Stephen Haynes, Mission Director of USAID/Skopje, which specifically requested help and gave the list of the areas where they needed help. In brief, while they needed help in many areas, the most urgent was for advisors to help with off-site supervision, methodology of supervision and the treatment of problem banks with the on-site training of the examiners in the US with the FDIC, OCC or FRB.

This letter gave the MBP the “franchise” to work directly with the SD and to work with them on issues that were crucial to them. It was also important for the success of the Project that they meet the expectations held by the SD at point. This “expectation” was an important factor in Booz Allen Hamilton’s strategic determination to make the SD the first of their priority customers and to build their own reputation in serving this customer.

Booz Allen Hamilton’s strategy was to find two top, recently retired senior level US bank examiners to come to Skopje on a prolonged assignment. The reason that Booz Allen Hamilton wanted two for a prolonged period was to give the STAs adequate time to know the people in the SD, to come to an understanding of the nuances of the issues that were pressing upon the SD and to have enough time to carefully work with the people on these issues. Booz Allen Hamilton was fairly confident at this point that the SD staff would not have much cognitive trouble with the technical side of these issues, but they really needed the perspective and counsel of seasoned, experienced supervisors for a longer time. Moreover, the SD was at a point where they were beginning to sense that supervision was a profession and that the objectivity and dedication of the SD was important to the integrity of the financial system. In other words, they were coming to see themselves as “special” people, important to the development of Macedonia. Booz Allen Hamilton felt that the reinforcement of this sense of purpose among the SD staff was equally, if not more, as important as their development than the technical assistance Bishev had requested.

To this end, Booz Allen Hamilton identified and secured for us the services of two exceptionally qualified men – Robert Hefner and Thomas Fitzgerald. The chemistry was excellent between these two and the staff at the SD. Things went so well in the Spring of 2000, that Booz Allen Hamilton brought them back for six weeks each in the Fall of 2000. Fitzgerald and Hefner covered a wide range of topics for the SD, including: (1) the use of CAMELS rating; (2) loan and credit concentrations; (3) an off-site supervision manual; (4) credit policies; (5) problem bank diagnosis and management; (6) on-site examination issues, (7) the SD’s organizational structure; (8) a bank governance manual; (9) a review of the examiners powers in the new bank legislation; (10) duties of bank audit committees; (11) dealing with bank management on enforcement issues; (12) steps to comply with BIS Core Principles of Supervision; and, (13) examiner file structures. The scope of the work done by Hefner and Fitzgerald, the quality of the work and the manner in which they shared these skills were the primary determinants of their success. Mr. Vincent Polizatto, a WB advisor, noted in particular the importance of the contribution of these STAs to the development of the SD at this time.

Subsequent to the consulting help from Hefner and Fitzgerald, Booz Allen Hamilton continued to work closely with the SD and other parts of the NBRM, culminating in June 2002 by bringing in the services of a specialist (a former OCC examiner) to bring the SD/NBRM in compliance with the Market Risk provision of the Core Supervisory Principals.

During the two and a half years in Skopje, Booz Allen Hamilton worked very closely with the SD staff. At the end, Booz Allen Hamilton admired their skills and their personal qualities. These people, and they are not alone, are indicative of the best hope of Macedonia. It is important that USAID continues to help and reinforce them whenever needed.

TASK FIVE: TRAINING OF MACEDONIANS

Task Five deals with the continuing education of the examiners and is indivisible from TASK FOUR. It is also a component part of Dr. Bishev's request for help from USAID. The technical details and the funding for the overseas training under this TO was provided by World Learning (WL). WL did an outstanding job in arranging the training and in getting just the right training for the people that Booz Allen Hamilton was sponsoring. Again, success was based on specializing the delivery of the services to the Macedonian unique needs.

Over the two and a half years, Booz Allen sent three groups to the US for three weeks training with the FDIC, OCC, FRB and various State examiners. Each group had five participants and each group had its own special objectives. These were very successful trips for several reasons: one of which was the willingness of the US examiners to include the Macedonian examiners in actual on-side examinations of banks. Once again, Booz Allen Hamilton felt that their technical understanding was very good, but what they needed was the direct experience of working with seasoned professionals in the field. The learning curve was straight up for the Macedonians in all respects.

In June, 2002, as the MBP's mission drew to a close, Ilija Graorkovski, Manager of the SD, told the Booz Allen Hamilton team that the Macedonian Bank had determined the course and character of the SD for many years to come. It was a joy to see the SD develop in the manner that it did.

TASK SIX: EXPANSION OF THE SUPERVISORY PROGRAM

Task Six encourages the MBP to promote the integration of the SD program with other USAID economic reform programs. This was somewhat difficult to achieve because the Macedonian culture is not to stray far from the legislated or designated base. It is a defensive mentality, especially compared to the American corporate mentality, which is to acquire as much turf as possible. The issue was complicated by the fact that the MOF controls all legislation relative to the financial sector and keeps most of the areas like capital markets, insurance and commercial finance under their direct control. It is possible that the main reason for this is that the Governor of the NBRM has (as in America) a long tenure. As a consequence the Governor was appointed by a different political party than is now in power. This seems to have been the source of some friction between the MOF and the NB. Notwithstanding this very Macedonian situation, there

were four areas in which Booz Allen Hamilton worked with other USAID projects on themes that involved the SD. These were: money laundering (FSVC), leasing legislation (FSVC), bank internal auditors (KPMG/Accounting) and National Payment Reform [ZPP] (US Treasury Department).

TASK SEVEN. REGIONAL LINKAGES OF NBRM

Task Seven involved developing inter regional linkages between the NB and their counterparts in other countries. In point of fact, personnel from almost all levels of the NB have been going for years to conferences at the Bank for International Settlements, IMF, USAID, EU and all manner of regional conferences. Through these conferences, the Macedonian NB developed close working relationships with other NBs in the region. At one point Booz Allen Hamilton suggested to the NB that they would help them set up a quarterly journal, or even a web-site, for regional bank supervisory or other NB issues, but they felt that the timing was not right for them; meaning that they did not have the staff to take on the long term management of such a task. In February 2002, an opportunity did arise to send SD staff to a USAID sponsored conference in Warsaw on the subject of the resolution of bad debt issued in banks. Given the Macedonian bank experiences, Booz Allen Hamilton thought this was a good opportunity for the Macedonian SD to look at the international players in the field, the types of resolutions and the experiences of other regulatory bodies. Accordingly Booz Allen Hamilton sent two SD staff members to this conference.

TASK EIGHT: FAIR ACCESS TO CREDIT AND BARRIERS TO CORRUPTION

Task Eight deals with promoting broad and fair access to credit, and building barriers to corruption and money laundering. These are immensely important issues and each, in all candor, should be the TO of separate projects. Nevertheless, in 2001 the Financial Service Volunteer Corps (FSVC) and the MBP joined forces to help the MOF draft legislation regarding money laundering. This legislation took some time to finish, but the law did become effective in March 2002. Booz Allen Hamilton's main interest in this legislation was to be sure that the banks' responsibilities with regard to record retention and regulatory notification were clearly indicated.

With regard to broad access to credit, the concept does not exist in the Macedonian bank mentality. The banks are just beginning to develop strategies for expanding credit to the retail sector. Also, although there are more banks than the country needs, there are comparatively few branches, so credit tends to be restricted to corporate and urban centers.

The use of PCs, however, is growing rapidly in Macedonia. The MBP, as a consequence held a seminar on electronic banking, designed to show the Macedonian bankers how to set-up web-sites for their products, how to market credit by electronic banking, how to manage the risks and other steps which would broaden their customer base and make bank services more available on a competitive basis through out the country. Subsequent to the seminar, several banks either revised or set-up new web sites with product descriptions and current pricing of the products (see Attachment Number 5).

UNWRITTEN OBLIGATIONS AND OPPORTUNITIES

In addition to the Task Orders (TO), as the CoP gained contacts and insights in to the Macedonian business system, he was increasingly called upon to share this information and to assist others. This is an essential part of the work even though it is not covered by a TO. Examples of this type of work are: (a) periodic briefings of the Ambassador or other embassy personnel regarding the status of the banking system; (b) briefing meeting for potential investors in Macedonia; (c) briefings with external agencies potentially rating Macedonian debt; (d) monthly briefings with the Minister of Finance; (e) meetings with USAID assessment teams from Washington; (f) consultations with the Macedonian university faculty regarding revisions in their curriculum; (g) review of assessment reports or potential projects for USAID; (h) background meeting with contractors bidding on projects in Macedonia; and, (i) frequent project up-dates with MBP USAID bosses in Skopje.

WHERE DOES USAID GO FROM HERE?

While the MBP has come to an end, Macedonia's need for USAID assistance in the financial sector will continue for many years. Specific areas where help is needed include: (a) the insurance and non-bank financial sector (commercial finance, leasing) is under developed and needs very basic help, (b) the SD/NBRM will need additional help to complete compliance with the Core Principals, such as Market Risk. In other regards, the banking industry itself is entering a period where interest rates and other money market risks will become a more serious factor, which raises the need for additional training of the bank examiners. The same applies to issues regarding the emergence of bank holding companies; and, (c) the commercial banking sector is still not providing the country with the financial leadership or serving as an engine to drive economic growth. This issue needs to be revisited, especially regarding how to solve the existing corpus of bad loans, which seems to be a serious drag on the industry's development (e.g. does Macedonia need a new bank bad debt agency?). The banking industry also needs an independent trade association to carry forward the training of people and represent the industry with authoritative and independent voice before the public and the legislature.